CANADIAN PIONEER OILS LTD.

1987 Annual Report

Canadian Pioneer Oils Ltd.

Corporate Profile

Canadian Pioneer Oils Ltd. (to be renamed Canadian Pioneer Energy, Inc.) is a Calgary based, public oil and gas corporation listed on the Alberta Stock Exchange. Incorporated in Alberta in 1978, the corporation is engaged in the exploration, development, production and acquisition of oil and gas in Canada and the United States. At August 31, 1987, the Corporation had 11,778,368 Class A Common Shares, 29,000 First Preference Shares and 600,000 Second Preference Shares outstanding. Northgate Exploration Limited, a Canadian public mining corporation, is the major shareholder, owning 8,051,856 common shares (69%) and 100,000 Second Preference shares (17%).

Notice of Annual Meeting

The Annual Meeting of Shareholders will be held at the Calgary Petroleum Club, 319 - 5 Avenue S.W., Calgary, Alberta on Wednesday, September 30, 1987 at 2:30 P.M. in the Viking A and B Rooms. At the meeting shareholders will be asked to approve a change of the name of the Corporation to Canadian Pioneer Energy Inc. and to approve the consolidation of the common shares on a one for four basis.

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Abbreviations

Throughout this report standard oil and gas abbreviations have been used as follows:

MSTB	Thousand Stock Tank Barrels
BOPD	Barrels of Oil per Day
BCF	Billion Cubic Feet
MCFD	Thousand Cubic Feet per Day
D&A	Dry and Abandoned

Financial and Operating Summary

Financial ($000)

	Year ended June 30 1987	1986
Production revenue	**$1,535**	$ 2,786
Funds provided by Operations	**$ 51**	$ 778
Loss for the year	**$ (656)**	$ (2,181)
Capital expenditures	**$ 849**	$ 1,631
Book value of assets	**$9,512**	$10,196
Long term debt	**$5,250**	$ 5,400
Shareholders' equity	**$2,797**	$ 3,135
Common shares outstanding	**11,778,368**	10,890,277

Operating

	1987	1986
Production		
Oil — barrels	**18,685**	25,986
— barrels per day	**51**	71
Gas — thousand cubic feet	**768,052**	866,995
— thousand cubic feet per day	**2,104**	2,375
Reserves (proven and probable)		
Oil — barrels	**253,900**	306,900
Gas — thousand cubic feet	**15,885,000**	16,263,500

Land Holdings

	DEVELOPED		UNDEVELOPED	
	Gross Acres	Net Acres	Gross Acres	Net Acres
Canada	80,096	7,418	70,723	25,169
United States	1,920	128	—	—

Wells Drilled

	Canada			United States			
Fiscal Year	Oil	Gas	D&A	Oil	Gas	D&A	Total
1983	—	22	6	2	—	2	32
1984	—	7	4	3	—	1	15
1985	6	10	11	2	1	1	31
1986	8	10	10	—	2	1	31
1987	3	5	3	—	1	—	12

Report of Directors

Fiscal 1987 was, as anticipated, a year of continuing weakness and instability in market prices for oil and gas with the resulting adverse impact on Canadian Pioneer's revenues and profits. However, late in the year the price of oil rebounded somewhat and the improvement has been maintained since year-end. On the operational side, the Corporation's production and reserves were essentially maintained during the year and an important new gas contract was concluded.

On the financial side, major achievements were made as Canadian Pioneer reduced operating costs, administrative expenses, long term debt and interest expense and, most importantly, arranged a very successful public financing, which was completed subsequent to year-end. This financing has placed the Corporation on a sound financial footing and has provided Canadian Pioneer with the resources to implement its ambitious plans for exploration, development and expansion and further reduction in long term debt.

Oil Price Weak — Gas Price Falls

At the beginning of the fiscal year, in July 1986, the oil price was at a low of Cdn. $16.00 per barrel and remained below Cdn. $20.00 per barrel for most of the year. However, in the fourth quarter the world price rebounded to the Cdn. $25.00 per barrel range. Unfortunately, the gas price did not fare as well and declined continuously throughout the year as a lack of demand was coupled with a warm winter in North America. The average price received on TransCanada Pipeline Contracts declined from $2.30 per mcf to $1.70 per mcf at year-end while spot prices fell to under $1.00 per mcf.

The effect of the lower product prices was a decline in Canadian Pioneer's net revenue from $2,786,000 in 1986 to $1,535,000 in 1987. Largely as a result of the lower revenue the Corporation recorded a loss for the year of $656,000 or $0.06 per share compared to a loss of $2,181,000 or $0.21 per share in 1986, which included a one time write-down in oil and gas properties of $2.6 million. Effective September 30, 1986 the Corporation sold its U.S. subsidiary, American Pioneer Oils Ltd. for $615,000 cash, $400,000 of which was applied to repay long term bank debt.

Operations Sustained

Production for the year declined somewhat, particularly in the first half of the year, due to the sale of the United States properties, reduced gas demand and the shut-in of a major oil property at Glenevis. The Corporation's oil and gas reserves showed little change from 1986 to 1987 with the sale of the United States properties offset by an 8% increase in proven and probable gas reserves in Canada. In January, 1987 an important three year contract was concluded with Bonus Gas Processors Limited to export an average of 3.3 million cubic feet of gas per day to end users in California. Sales under this contract began in May, 1987.

Improved Financial Position

In response to declining production revenues the Corporation moved to reduce its costs and improve its financial position. Production expenses declined by 29%, due in part to lower production but also because of more efficient operation of properties. General and administrative expenses were reduced by 25% from $579,000 to $441,000. Long term debt was reduced by $400,000 and interest expense declined by 13%. However, it was recognized that cash flow alone, while remaining positive, would not be sufficient to fund growth and increase value. Accordingly, a major effort was directed at arranging a public financing which would provide new equity. This $6 million financing, which was successfully completed subsequent to year-end, comprised the public issue of oil price indexed convertible preference shares and gold purchase warrants.

The innovative structure of the financing was found very attractive by investors as it provides exposure to the two major commodities oil and gold. The preference shares, which are now listed on the Alberta Stock Exchange, were issued as Second Preference Shares Series A, have a dividend rate of $0.96, equivalent to 8.0%, and are convertible into common shares at $0.45 per share until May, 1991 and thereafter at $0.57 per share until May, 1994. The Second Preference Shares are also oil price indexed in that the holder will be paid an additional yearly dividend of 10% of any increase in the average daily price of Arabian Light Crude above US$22.00 per barrel. The gold purchase warrants, which are also listed on the Alberta Stock Exchange, were acquired from the Corporation's major shareholder, Northgate Exploration Limited, and entitle the holder to purchase, through the Corporation from Northgate, 0.02 ounces of gold at the equivalent of US$550 per ounce until May, 1990. Northgate also subscribed for an additional $1 million of Second Preference Shares in addition to the $6 million sold to the public.

During the year Canadian Pioneer also entered into two agreements to raise $650,000 for expenditure on exploration through the issue of flow-through shares. Of this amount $487,000 remained available at year-end for expenditure on exploration in fiscal 1988.

Optimism for 1988

Canadian Pioneer looks forward to 1988 with renewed optimism and in a much improved financial condition. The new financing will enable the Corporation to pursue its objectives of increasing production and revenues through exploration and development. Gas production will be increased through ongoing marketing efforts in Canada and the United States. A reduction in long term debt of at least $1.25 million will be achieved partly from the proceeds of the public financing and partly with the proceeds of funds generated under the Federal Government's Canadian Exploration and Development Incentive Program which rebates one-third of eligible exploration and development expenditures. In addition, suitable acquisitions or mergers will continue to be pursued with the objective being to increase Canadian Pioneer's asset base and create a company of more efficient size.

Change of Name and Consolidation of Shares

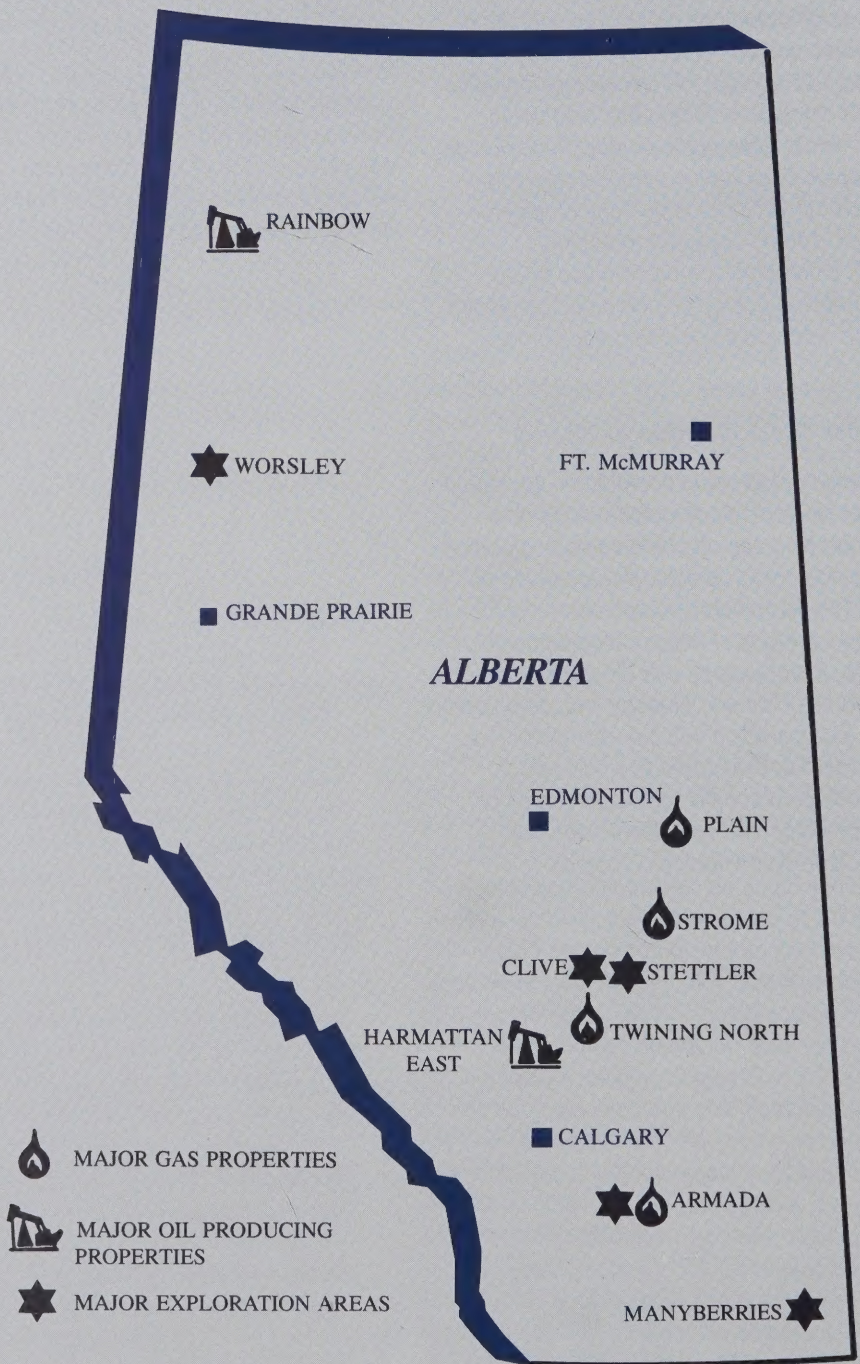
On the recommendation of the Corporation's financial advisors and in order to improve the market for the Corporation's common shares, shareholders are being asked at the forthcoming Annual Meeting to approve the consolidation of the common shares on a one for four basis. At the same time, and as required by various regulatory provisions, the name of the Corporation will be changed to Canadian Pioneer Energy Inc. and the stated capital of the Corporation will be reduced. The effect of these changes is that after the meeting shareholders will receive one new common share of Canadian Pioneer Energy Inc. for every four old common shares of Canadian Pioneer Oils Ltd.

Acknowledgements

Late in the year Mr. P.S. Davids resigned as a director of the Corporation. His contribution to the Corporation over the past eight years is gratefully acknowledged. To fill the vacancy, Mr. Alex S. Cathcart, a petroleum geologist with many years experience in the Canadian oil and gas industry was appointed as a director.

The Board of Directors would like to welcome the new shareholders of the Corporation and thank them for their confidence in Canadian Pioneer. The Board also wishes to acknowledge the support of employees and all shareholders during what is hoped will be regarded as the turn-around year for the Corporation.

September 15, 1987


RAINBOW
WORSLEY
FT. McMURRAY
GRANDE PRAIRIE
ALBERTA
EDMONTON
PLAIN
STROME
CLIVE
STETTLER
HARMATTAN
EAST
TWINING NORTH
CALGARY
ARMADA
MANYBERRIES
MAJOR GAS PROPERTIES
MAJOR OIL PRODUCING
PROPERTIES
MAJOR EXPLORATION AREAS

Exploration and Development

Major efforts in 1987 were directed on planning a renewed exploration and development program. Canadian Pioneer is concentrating its activities in the southern and central part of Alberta with an emphasis on accelerating exploration and development for new oil reserves. Land purchases and farm-in commitments have been made or are being made in the Armada, Bindloss, Manyberries and Red Coulee areas of Southern Alberta. In Central & Northern Alberta activity is taking place in the Stettler, Joffre, Morningside and Worsley areas. The Corporation intends to develop and operate more of its own exploration prospects retaining a meaningful working interest in each prospect.

Gas prospects will continue to be pursued in areas of Alberta where facilities and pipelines are available for processing and delivery of gas at a reasonable cost. In addition, during the next year the Corporation will be undertaking geological and geophysical studies in southern and central Alberta where the Corporation plans to rebuild its acreage through land purchases and farm-ins.

Land Activity

Land holdings in the United States during 1987 were reduced by 69,335 gross acres (2,829 net acres) as a result of the sale of the Corporation's wholly-owned United States subsidiary, American Pioneer Oils Ltd.

In Canada, where the Corporation is concentrating its exploration activities, a number of development and exploration prospects have been identified, and an aggressive program of leasing and farm-ins is being pursued.

The Corporation's land holdings as of June 30, 1987 were as follows:

	DEVELOPED		UNDEVELOPED	
	Gross Acres	Net Acres	Gross Acres	Net Acres
Canada	80,096	7,418	70,723	25,169
United States	1,920	128	—	—

Drilling Activity

During 1987 drilling activity was conducted at a reduced level due to economic and financial constraints. The Corporation participated in the drilling of 12 wells in 1987, two of which were farmout wells drilled at no cost to the Corporation. Canadian Pioneer participated in three exploratory wells in the Rainbow area resulting in two producing Keg River oil wells which are each currently producing in excess of 200 barrels of oil per day. Canadian Pioneer has an average of 2.1% working interest in the two wells.

In the Armada area of Alberta the Corporation participated for a 30% working interest in a 4200 foot exploratory test in May, 1987. Subsequent to year-end the gas well was tied in and placed on production at a rate of 2250 MCFD.

In the Twining North and Buck Lake areas of Alberta Canadian Pioneer participated in the drilling of two shut-in gas wells.

WELLS DRILLED

	Canada			United States			
Fiscal Year	Oil	Gas	D&A	Oil	Gas	D&A	Total
1983	—	22	6	2	—	2	32
1984	—	7	4	3	—	1	15
1985	6	10	11	2	1	1	31
1986	8	10	10	—	2	1	31
1987	3	5	3	—	1	—	12

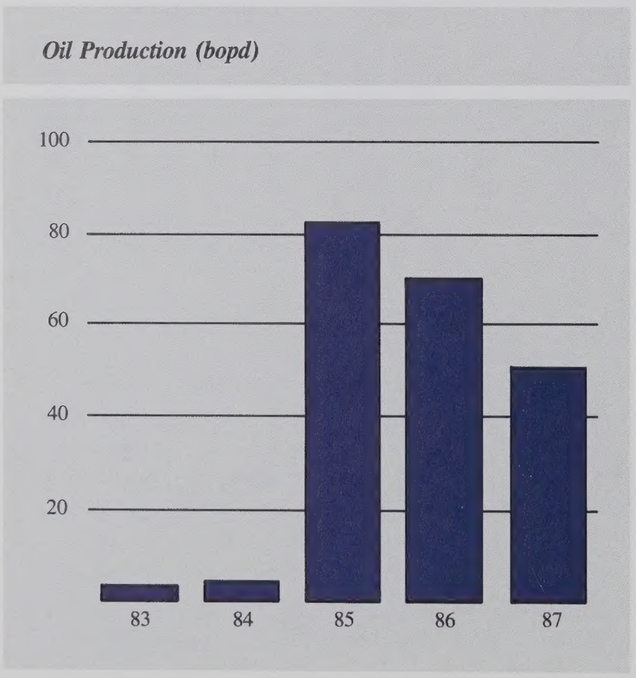
Production and Operations

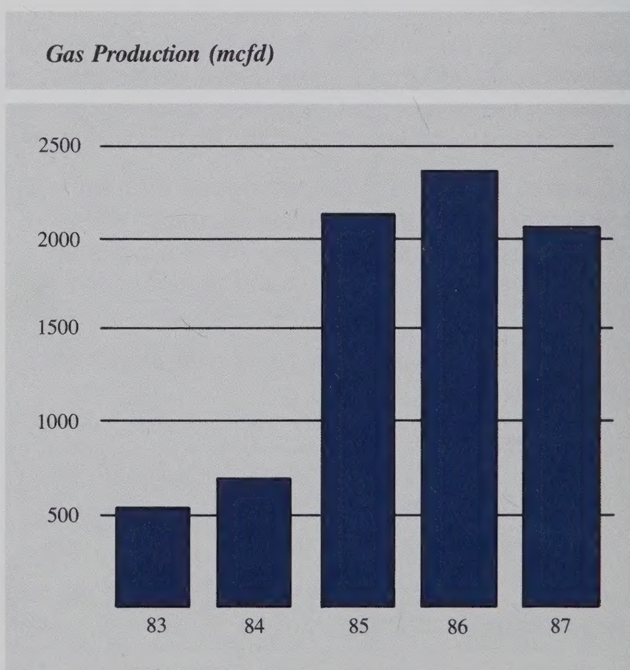
Gas production during 1987 declined 12% to 768 million cubic feet (2140 MCFD) from 867 million cubic feet (2375 MCFD) in 1986. The primary reason for the reduced gas production was the sale of properties effective September 30, 1986 and reduced nominations for gas in Canada. Oil production also decreased in 1987 to 18,685 barrels (51 BOPD) from 25,986 barrels (71 BOPD) in the previous year. The shut-in of the Glenevis oil property due to low prices for 9 months of fiscal 1987, the sale of the U.S. properties, and lower production from the Harmattan East Viking Unit No. 1 contributed to the decline in oil production.

In the latter half of fiscal 1987, gains were made in oil and gas production. The Glenevis oil property resumed production in late March, 1987 contributing an additional 18 BOPD net to the Corporation and new oil production was placed on stream in the Rainbow and Hays areas of Alberta. Gas production increased from late May, 1987 from properties delivering to the new California gas contract.

In September 1987 a new gas well in the Armada area was placed on production at a rate of 2250 MCFD delivering to the California contract. Canadian Pioneer has a 30% working interest in the well and is planning to develop more production in this area of Alberta.

At June 30, 1987 the Corporation had interests in 88 producing oil wells and 53 producing gas wells in Canada.

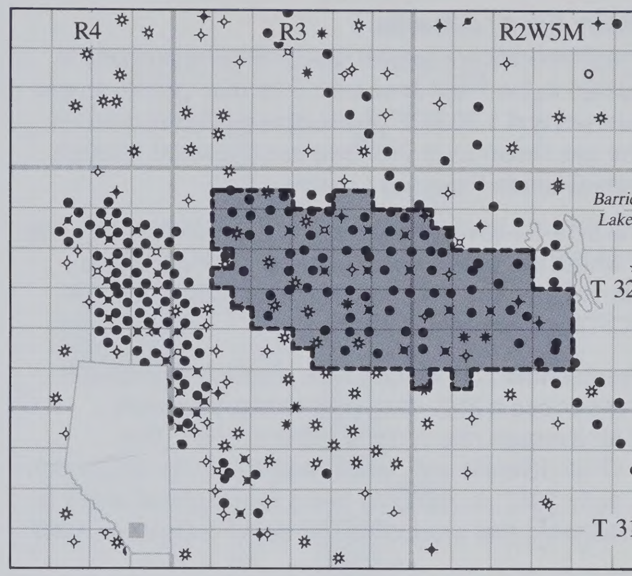




Harmattan East Area, Alberta

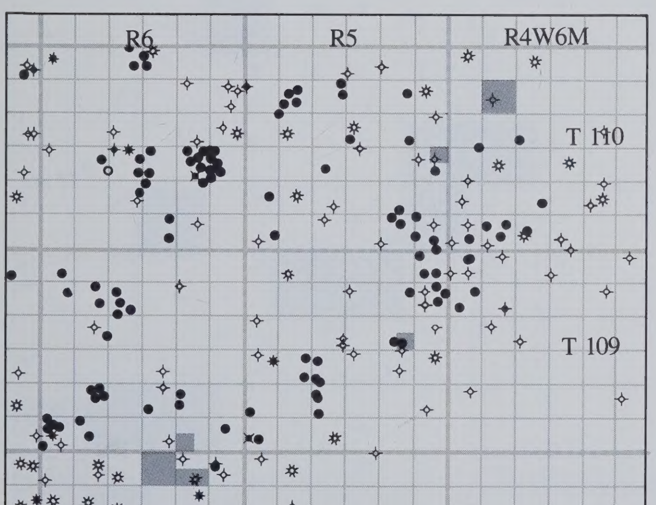
As of October 1, 1986, the Corporation's five producing oil wells in the Garrington area of Alberta were included in the Harmattan East Viking Unit No. 1. Canadian Pioneer owns a 0.9% working interest in this unit which contains 68 Viking oil wells. Production from the unit has recently averaged 935 barrels per day (9 BOPD net to the Corporation).

This property remains as the Corporation's largest oil property in terms of reserves with 93,000 barrels of proven reserves and an additional 25,000 barrels of probable reserves.

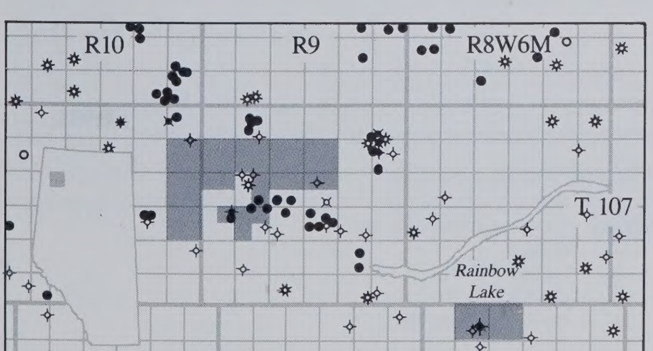


HARMATTAN EAST AREA, Alberta

CANADIAN PIONEER Land
Location
Oil Well
Gas Well
Oil & Gas Well
Dry & Abandoned Well
Abandoned Oil/Water Injection
Viking No. 1 Unit Outline



N.E. RAINBOW AREA, Alberta



S.W. RAINBOW AREA, Alberta

CANADIAN PIONEER Land
Location
Oil Well
Gas Well
Oil & Gas Well
Dry & Abandoned Well
Abandoned Oil/Water Injection

Rainbow Area, Alberta

The Rainbow area is the Corporation's largest oil producing property in terms of daily production and second largest in terms of reserves with 50,000 barrels of proved reserves and an additional 9000 barrels of probable reserves. Canadian Pioneer's current net daily oil production from the Rainbow area averages 25 BOPD.

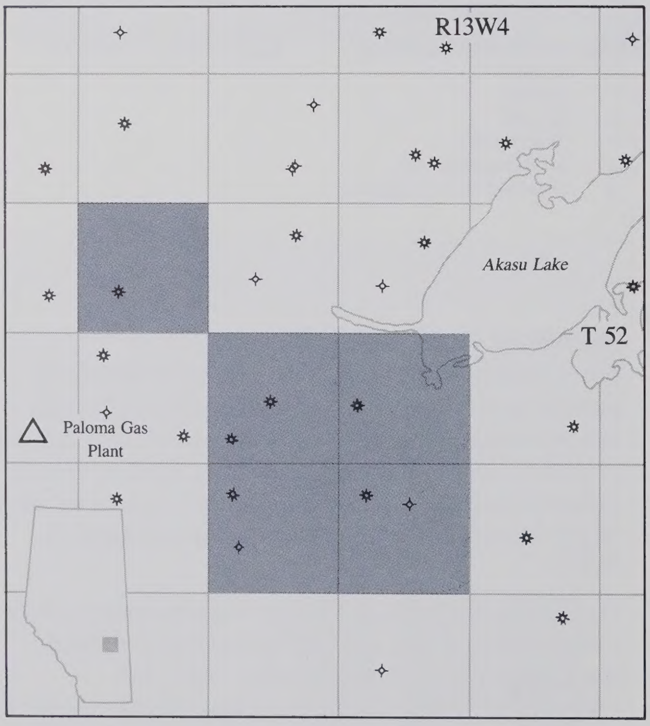
The Corporation owns working interests ranging from 1.8% to 2.8% in five producing Keg River oil wells, two of which were drilled in fiscal 1987. The 2-23-109-5W6M well has produced 238,000 barrels of oil since going on stream in August 1983, and is currently producing at a rate of 200 barrels per day. The 2-20-107-9W6M well, which went on stream in June 1982, has produced 385,000 barrels of oil, and is producing at a rate of 250 barrels per day. The 9-18-107-9W6M well was placed on stream in August 1983, and is currently producing 250 barrels per day, with cumulative production of 354,000 barrels. The 16-17-107-9W6M well in which the Corporation owns a 1.761% working interest was completed as an oil producer in November 1986 and to June 1987 had produced 69,000 barrels. The current daily production averages 275 BOPD. The 14-17-107-9W6M well in which Pioneer has a 2.43% working interest started production in January 1987 and produced 36,000 barrels to the end of June 1987.

Plain Area, Alberta

The Corporation's largest gas producing property is located in the Plain area with 2.79 BCF of proven gas reserves and 1.79 BCF of probable additional reserves. The gas reserves in this area are marketed through TransCanada Pipelines Limited.

The 6-19-52-13W4M and the 13-8-52-13W4M gas wells, in which the Corporation owns a 37.5% working interest, produced at average rates of 720 and 205 MCFD respectively in 1987.

The 6-17-52-13W4M gas well, in which Canadian Pioneer has a 25% working interest, produced at an average rate of 980 MCFD in 1987. The 4-17-52-13W4M well, which was tied-in for production in early 1987, is currently being recompleted and it is anticipated that production will begin in October, 1987.

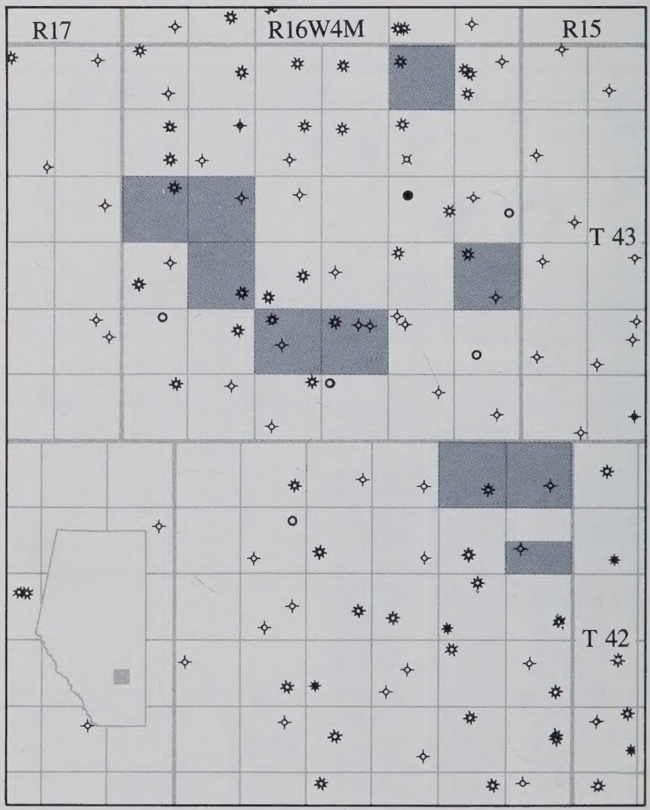


PLAIN AREA, Alberta

CANADIAN PIONEER Land
o Location
Gas Well
Dry & Abandoned Well

Strome Area, Alberta

In the Strome area, which is Canadian Pioneer's second largest gas producing property, the Corporation owns varying interests in four producing and three shut-in gas wells. Canadian Pioneer's gas reserves in the Strome area amount to 1.6 BCF proved reserves and 1.0 BCF probable additional reserves. The 1-17-43-16W4M well, in which the Corporation owns a 16.25% working interest, produced at an average rate of 1500 MCFD during 1986. The 2-35-42-16W4M (24.7% working interest) produced at 120 MCFD due to lower nominations for gas in this area. Two other wells in which Canadian Pioneer has gross overriding royalty interests until payout are also producing. The gas reserves in this area are sold through Trans-Canada PipeLines Limited.

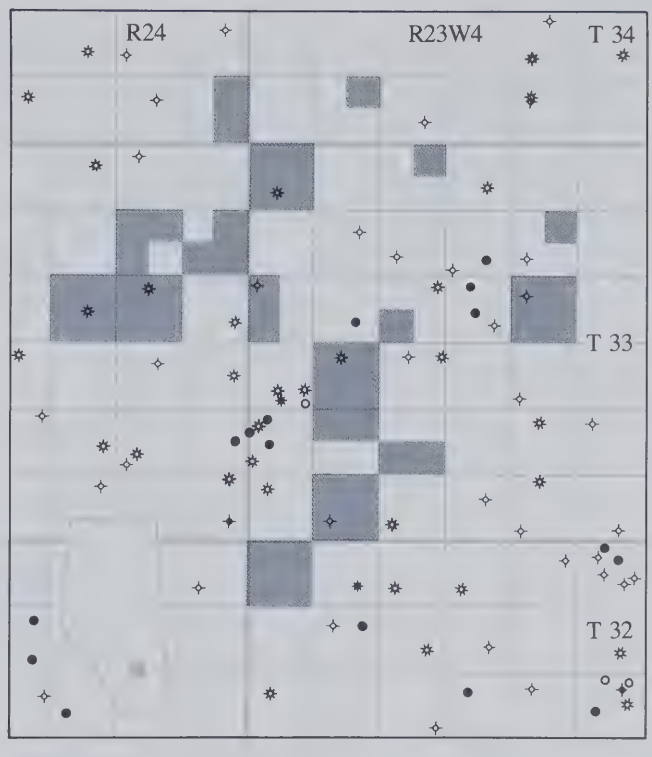


STROME AREA, Alberta

CANADIAN PIONEER Land
o Location
● Oil Well
Gas Well
Dry & Abandoned Well

Twining North Area, Alberta

In the Twining North area the Corporation owns an interest in one producing and three shut-in gas wells. The Pioneer Twinn 14-23-33-24W4M well, in which Canadian Pioneer has a 28.4% working interest before payout and a 32.94% working interest after payout, was tied in for production in December, 1986. The well began production that month and produced to intermittent spot market sales until late May, 1987. Since then, this well has produced gas at rates of up to 3300 MCFD for export to the United States. The Corporation also has working interests in three shut-in gas wells in this area which will be tied in when processing capacity becomes available and economics are favourable.



TWINING NORTH AREA, Alberta

CANADIAN PIONEER Land
Location
Oil Well
Gas Well
Oil & Gas Well
Dry & Abandoned Well
Abandoned Oil/Water Injection

Marketing

During fiscal 1987 Canadian Pioneer moved aggressively to gain new gas contracts for its substantial gas reserves. In January, 1987 the Corporation signed a three-year contract with Bonus Gas Processors Ltd. to supply an average 3.3 million cubic feet of gas per day to end users in the State of California. Canadian Pioneer began to sell gas to this contract in May, 1987 and is currently selling up to 5.0 million cubic feet per day on behalf of itself and working interest partners. The delivery of gas to California is currently subject to availability of pipeline capacity in the Pacific Gas Transmission System.

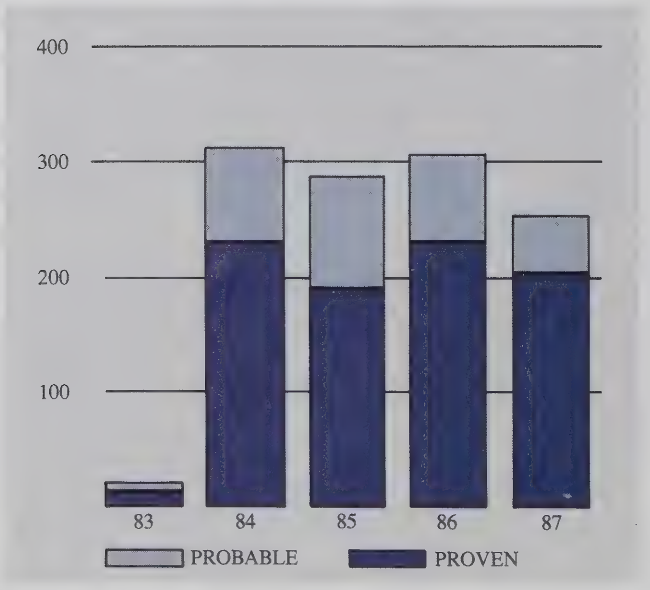
Canadian Pioneer is funding an effort to develop new gas markets in the United States and is anticipating that this will lead to additional gas sales during the next year. The Corporation is also pursuing new gas markets in Canada and is looking for contracts with high load factors to offset the lower Canadian prices being offered. Indications are that the gas surplus in North America is now in a decline and this should arrest the downward slide of gas prices and see them return to more normal price levels in relation to oil.

Reserves

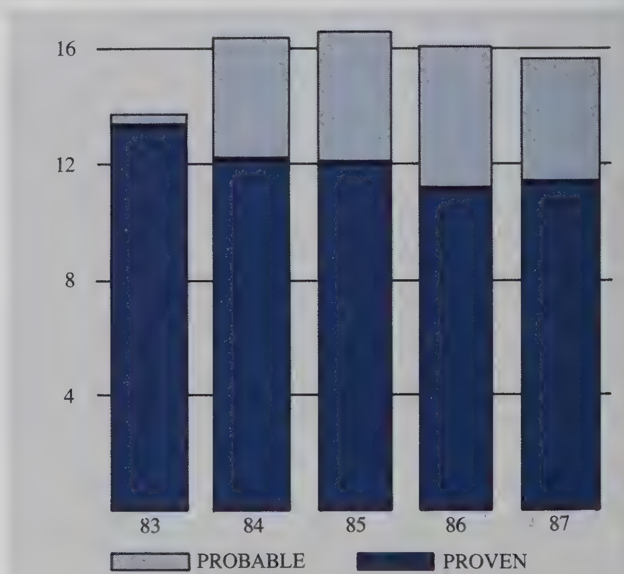
Canadian Pioneer's major oil and gas properties, representing approximately 80 percent of the Corporation's total reserves, were evaluated at July 1, 1987 by Coles Nikiforuk Pennell Associates Ltd., an independent engineering consulting firm. The minor properties, which represent about 20 percent of total reserves, were evaluated by Les P. Fetterly, P. Eng., an independent consulting engineer. Total reserves changed very little from 1986 to 1987 with an 8 percent increase in proven and probable gas reserves in Canada. The United States properties were sold effective September 30, 1986.

	Reserves Before Royalties						Discounted Value of Estimated Future Net Revenues Before Income Taxes		
	Canada		United States		Total				
	Oil	Gas	Oil	Gas	Oil	Gas			
	MSTB	BCF	MSTB	BCF	MSTB	BCF	0%	10%	15%
Proven	201.0	11.5	—	—	201.0	11.5	$31,470	$13,979	$10,530
Probable	52.9	4.4	—	—	52.9	4.4	17,296	4,924	3,181
Proven and Probable	253.9	15.9	—	—	253.9	15.9	$48,766	$18,903	$13,711

Crude Oil Reserves (mstb)



Natural Gas Reserves (bcf)



Financial Review

For the year ended June 30, 1987 the Corporation recorded a loss of $656,000 or 6 cents per share compared with a loss of $2,181,000 or 21 cents per share for the corresponding period of 1986. Results for 1987 include an extraordinary loss of $145,000 on the sale of substantially all of the Corporation's U.S. oil and gas properties for $615,000. Results for 1986 included a one time write-down of oil and gas properties in the amount of $2,593,000.

The improvement in results in the current year is mainly attributable to lower depletion and depreciation, general and administrative and production expenses, which were partly offset by lower revenue from oil and gas sales.

With low oil prices for much of the year, a 35% drop in gas prices and reduced production volumes, mainly as a result of the sale of the U.S. properties, net production revenues declined to $1,535,000 from $2,786,000 in 1986. Production expenses declined by 29% to $491,000 in 1987 from $689,000 in 1986 because of lower oil and gas production and improved operating efficiencies. Similarly, general and administrative expenses were reduced by 25% to $441,000 from $579,000.

Depreciation and depletion declined by $2,499,000 to $539,000 in 1987 from $3,038,000 in 1986. This reduction is mainly attributable to a one time write-down in 1986 of the Corporation's oil and gas properties following the drastic decline in oil prices in early 1986.

During the year the Corporation issued 738,091 flow-through common shares for total proceeds of $310,000 and has agreed to issue an additional 1,465,974 flow-through common shares for proceeds of $513,000 to be used on eligible exploration expenses by February 28, 1988.

Long term debt was reduced by $400,000 during the year from part of the proceeds of the sale of the U.S. properties. At June 30, 1987 long term debt amounted to $5,250,000 and is expected to be reduced by a further $1,250,000 by early 1988.

Subsequent to the year-end Canadian Pioneer raised $6 million through the public issue of 500,000 units each comprised of a $12.00 oil price indexed convertible second preference share and a gold purchase warrant. A further $1 million was raised by the concurrent sale of convertible second preference shares to Northgate Exploration Limited. After expenses of the issue estimated at $450,000 including commission, and the purchase for $1 million of an option on 10,000 ounces of gold, the net proceeds to the Corporation amounted to $5,550,000.

A revised agreement has been reached with the Corporation's banker which will allow Canadian Pioneer to reduce its long term debt by up to $1 million with the proceeds received from CEDIP qualified expenditures with a further $250,000 of debt being repaid from proceeds of the issue.

The financing and debt reduction has significantly improved the Corporation's financial position which had been severely strained as a result of the fall in oil and gas prices and a highly levered debt structure.

Auditors' Report

To the Shareholders of
Canadian Pioneer Oils Ltd.

We have examined the consolidated balance sheet of Canadian Pioneer Oils Ltd. as at June 30, 1987 and the consolidated statements of operations, deficit and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the corporation as at June 30, 1987 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Calgary, Canada
August 28, 1987

Thorne Ernst & Whinney

Consolidated Balance Sheet

ASSETS

	June 30 1987	June 30 1986
CURRENT ASSETS		
Cash	$ —	$ 42,792
Accounts receivable	488,311	620,337
Receivable from affiliated company	36,500	—
Prepaid expenses	159,584	100,000
	684,395	673,129
NOTES RECEIVABLE (note 1)	199,000	272,139
PROPERTY, PLANT AND EQUIPMENT, at cost		
Petroleum and natural gas interests including exploration, development and equipment thereon	10,621,932	14,180,826
Accumulated depletion and depreciation	1,993,224	4,929,508
	8,628,708	9,251,318
	$ 9,512,103	$10,196,586

LIABILITIES AND SHAREHOLDERS' EQUITY

	1987	1986
CURRENT LIABILITIES		
Bank advances (note 2)	$ 385,715	$ 250,000
Accounts payable and accrued liabilities	1,001,767	827,947
Current portion of long term debt	—	250,000
	1,387,482	1,327,947
LONG TERM DEBT (note 3)	5,250,000	5,400,000
DEFERRED PRODUCTION REVENUE	77,615	333,898
SHAREHOLDERS' EQUITY		
Capital stock (note 4)		
First Preference shares, Series A	505,613	505,613
First Preference shares, Series B	200,000	200,000
Class A voting common shares	7,044,634	6,689,634
	7,750,247	7,395,247
Deficit	(4,953,241)	(4,260,506)
	2,797,006	3,134,741
	$ 9,512,103	$10,196,586

Subsequent events (note 8)

APPROVED BY THE BOARD

Director

D.H. Erickson

Director

John F. Kearney

Consolidated Statement of Operations

	Year ended June 30 1987	1986
Revenue		
Petroleum and natural gas sales, net of royalties	**$1,535,057**	$ 2,786,318
Expenses		
Production	**491,343**	689,106
General and administrative	**441,289**	579,014
Interest on long term debt	**546,980**	626,486
Other interest	**28,116**	34,303
Depletion and depreciation	**538,637**	3,038,162
	2,046,365	4,967,071
Loss before extraordinary item	**(511,308)**	(2,180,753)
Extraordinary item		
Loss on sale of U.S. subsidiary (note 5)	**(145,177)**	—
LOSS FOR THE YEAR	**$ (656,485)**	$(2,180,753)
LOSS PER COMMON SHARE		
Before extraordinary item	**$(0.05)**	$(0.21)
Loss	**$(0.06)**	$(0.21)

Consolidated Statement of Deficit

	Year ended June 30 1987	1986
Deficit at beginning of year	**$(4,260,506)**	$(2,007,253)
Loss for the year	**(656,485)**	(2,180,753)
Dividends paid on preference shares	**(36,250)**	(72,500)
DEFICIT AT END OF YEAR	**$(4,953,241)**	$(4,260,506)

Consolidated Statement of Changes in Financial Position

	Year ended June 30 1987	1986
CASH PROVIDED BY (USED FOR):		
OPERATIONS		
Loss before extraordinary item	**$(511,308)**	$(2,180,753)
Items not involving cash		
Depletion and depreciation	**538,637**	3,038,162
Deferred production revenue	**(11,817)**	(79,855)
Other	**35,434**	—
	50,946	777,554
Change in non-cash working capital	**47,504**	678,186
	98,450	1,455,740
FINANCING		
Notes receivable	**37,705**	33,154
Long term debt	**(400,000)**	(500,000)
Issue of common shares	**355,000**	440,537
Dividends	**(36,250)**	(72,500)
	(43,545)	(98,809)
INVESTMENTS		
Additions to property, plant and equipment	**(848,883)**	(1,630,918)
Proceeds on sale of property, plant and equipment	**—**	48,009
Proceeds on sale of U.S. subsidiary	**615,471**	—
	(233,412)	(1,582,909)
DECREASE IN CASH POSITION	**(178,507)**	(255,978)
Cash position at beginning of year	**(207,208)**	18,770
CASH POSITION AT END OF YEAR	**$(385,715)**	$ (207,208)
Cash position is comprised of:		
Cash	**$ —**	$ 42,792
Bank advances	**(385,715)**	(250,000)
	$(385,715)	$ (207,208)

Notes to Consolidated Financial Statements

Year Ended June 30, 1987

GENERAL

The Corporation is incorporated under the Business Corporations Act (Alberta) and its principal business activities include the exploration, development, production and acquisition of petroleum and natural gas in Canada and the United States.

The Corporation is a subsidiary of Northgate Exploration Limited ("the Corporation's parent").

SUMMARY OF SIGNIFICANT POLICIES

Consolidation

The Corporation's financial statements include the accounts of Canadian Pioneer Oils Ltd. and its wholly owned subsidiary companies (note 5).

Petroleum and Natural Gas Operations

The Corporation follows the full cost method of accounting for petroleum and natural gas operations whereby all costs of exploring for and developing petroleum and natural gas reserves are capitalized on a country by country basis. Costs include land acquisition costs, geological and geophysical expenditures, carrying charges on non-producing property, costs of drilling both productive and non-productive wells, related overhead expenditures and capitalized interest related to major development projects.

Capitalized costs in each cost centre are limited to an amount equal to the estimated future net revenues from proved reserves, based on current prices and costs, plus the lower of cost or estimated fair value of unproved properties. The aggregate of such future net revenues and unproved properties for all cost centres is further reduced by estimated future aggregate general and administrative expenses, financing costs and income taxes.

Gains or losses are recognized upon the sale or disposition of property when the petroleum and natural gas reserves of the property are significant in relation to the Corporation's total reserves in the cost center.

Substantially all the Corporation's exploration and development activities related to petroleum and natural gas are conducted jointly with others. The accounts reflect only the Corporation's proportionate interest in such activities.

Depletion and Depreciation

Depletion and depreciation of petroleum and natural gas properties, plant and equipment is provided using the unit of production method based upon estimated proved reserves as determined by the Corporation and independent consultants. Costs of unproved properties and major development projects are excluded from the depletion calculation until it is determined whether proved reserves exist, major development projects are complete, or impairment occurs. In calculating depletion and depreciation, crude oil reserves are converted to equivalent units of natural gas based on the relative energy content of each product.

Depreciation of property, plant and equipment is provided using a declining balance basis over the estimated life of each asset at annual rates varying from 10% to 30%.

Foreign Currency Translation

Financial statements of the Corporation's subsidiary are translated as follows:

Monetary assets and liabilities at year-end exchange rates; all other assets and liabilities at historical rates.

Revenue and expense items are translated at average rates prevailing during the year except for depletion and depreciation which are translated at historical rates.

Exchange gains or losses, other than those resulting from long term debt, are included in the determination of net income for the year. Exchange gains or losses resulting from long term debt are deferred and amortized over the repayment period of the liability.

1. ***Notes Receivable***

	1987	1986
Non-interest bearing repayable in annual instalments of $33,000 on January 1 of each year	$ 99,000	$132,000
Interest bearing at 10% due January 1, 1990	100,000	100,000
Non-interest bearing note receivable	—	40,139
	$199,000	$272,139

2. ***Bank Advances***

A demand revolving operating line of credit in the amount of $500,000 has been established with the Corporation's bank. In addition to the $385,715 of advances to June 30, 1987, the bank has issued an irrevocable letter of credit in the amount of $100,000 in respect of a gas marketing agreement.

3. ***Long-Term Debt***

	1987	1986
Bank loan	$5,250,000	$5,650,000
Less amount due within one year	—	250,000
	$5,250,000	$5,400,000

The loan bears interest at the bank's prime rate plus ½% and is secured by petroleum and natural gas interests.

The bank loan is available to a maximum of $5,250,000 until September 14, 1987, at which date the credit facility reduces to $5,000,000. In February 1988, the amount of the credit facility and payments to maturity will be subject to redetermination by the Corporation's bank. Based upon the existing loan agreement and the balance outstanding at June 30, 1987, the estimated payments until maturity would be as follows: 1988 — $1,250,000, 1989 — $1,000,000, 1990 — $1,000,000, 1991 — $1,000,000, 1992 — $1,000,000.

The 1988 payments will be funded with the proceeds from the financing completed subsequent to June 30, 1987 (see note 8) and accordingly no portion of the loan outstanding at June 30, 1987 has been classified as a current liability.

4. ***Capital Stock***

Authorized

8,000,000 First Preference shares with a stated capital of $25 per share, issuable in series, of which 100,000 shares have been designated as Series A 10% cumulative, redeemable, non-voting, convertible first preference shares and 20,000 have been designated as Series B 10% cumulative, redeemable, retractable, non-voting, convertible preference shares.

20,000,000 Second Preference shares with a stated capital of $10 per share, issuable in series.

100,000,000 Class A voting Common Shares without nominal or par value.

Issued Preference Shares

21,000 First Preference shares, Series A

8,000 First Preference shares, Series B

The First Preference shares, Series A may be converted at any time up to June 30, 1988, at the option of the holder, into Common Shares of the Corporation. The conversion price is $3.50 per Common Share. Dividends on First Preference shares, Series A are payable quarterly. These shares are non-voting unless the Corporation has failed to pay dividends for six quarters whether or not consecutive.

The Corporation may redeem the First Preference shares, Series A at any time provided that the current market price of the Common Shares on the date of notice of redemption exceeds 130% of the conversion price then in effect. The First Preference shares, Series A were redeemable at $26.25 per share to June 30, 1986, thereafter declining annually by $0.25 until June 30, 1991. The Corporation is obligated to make all reasonable efforts to purchase for cancellation 1½% of the issued and outstanding First Preference shares, Series A quarterly.

The First Preference shares, Series B may at any time, at the option of the holder, be converted to Common Shares at a rate of 44 Common Shares for one First Preference share, Series B. The holder may require the Corporation to repurchase or the Corporation may redeem the shares at any time at $25.00 per share together with any declared and unpaid dividends.

Dividends on the First Preference shares, Series A and Series B have been declared and paid to February 28, 1987 and dividends in arrears at June 30, 1987 amount to $26,250 and $10,000, respectively. Dividends on First Preference shares, Series A and Series B in arrears at September 1, 1987 will be $39,375 and $15,000, respectively. The Corporation intends to pay all dividends on September 30, 1987.

Issued Common Shares

	Number of Shares	Consideration
Balance June 30, 1985	10,454,947	$6,249,097
Shares issued		
For flow through exploration expenditures	435,330	440,537
Balance June 30, 1986	10,890,277	6,689,634
Shares issued		
For flow through exploration expenditures	738,091	310,000
For services rendered	150,000	45,000
Balance June 30, 1987	11,778,368	$7,044,634

During the year, the Corporation agreed to issue a total of 150,000 Common Shares at an ascribed value of $45,000 to certain officers in consideration for services rendered.

During the year, the Corporation agreed to issue up to 857,551 Common Shares for flow through exploration expenditures at an average issue price of approximately $0.35 per share. At June 30, 1987, 391,577 shares have been issued pursuant to this agreement. Subsequent to June 30, 1987, the Corporation agreed to issue up to 1,000,000 Common Shares for flow through expenditures at an average issue price of $0.35 per share. The proceeds of these share issues will be committed exclusively for petroleum, natural gas and mineral exploration purposes in Canada. The purchaser of the shares acquires the rights to any related income tax benefits arising from the expenditures.

Reserved Common Shares

502,000 Common Shares have been reserved for the conversion of First Preference Shares, Series A and Series B.

Options to purchase 1,175,000 Common Shares are outstanding, exercisable from time to time to November, 1990 at $0.33 per share. Options to purchase 345,000 Common Shares are outstanding, exercisable from time to time to October, 1987 at $0.60 per share.

5. *Loss on Sale of U.S. Subsidiary*

Effective September 30, 1986, the Corporation sold a wholly owned U.S. subsidiary, American Pioneer Oils Ltd., for cash proceeds of $615,471. American Pioneer Oils Ltd. held substantially all of the Corporation's U.S. petroleum and natural gas properties.

6. *Income Taxes*

The income tax provisions in 1987 and 1986 differ from the amounts that would have resulted had the Canadian federal statutory tax rate been applied to the loss before extraordinary item, as follows:

	1987		1986	
	Amount	Percent	Amount	Percent
Computed income tax expense (recovery) at statutory rate	$(235,202)	(46)	$(1,003,146)	(46)
Increase (decrease) resulting from:				
Non-deductible crown charges	60,410	13	110,036	5
Alberta Royalty Tax Credit	(35,074)	(8)	(58,354)	(3)
Resource allowance	(65,328)	(14)	(83,031)	(4)
Non-deductible depletion and depreciation	60,021	13	52,900	3
Losses not currently utilized	215,173	42	981,595	45
Income tax provision	$ —	—	$ —	—

At June 30, 1987, the Corporation has the following amounts available to reduce future years' income for tax purposes, the tax effect of which has not been recorded in the accounts.

Capital losses carried forward deductible against future capital gains	$2,200,000
Net timing differences resulting from interest charges capitalized for tax purposes and expensed for financial reporting purposes	2,200,000
	$4,400,000

7. *Segmented Information*

The Corporation is primarily engaged in one industry, petroleum and natural gas exploration, development and production. The following table, which includes the operations of American Pioneer Oils Ltd. to September 30, 1986, provides financial information for the Corporation's operations by geographic segment:

	1987		
	Canada	United States	Total
Petroleum and natural gas sales	$1,434,162	$100,985	$1,535,057
Operating profit	$ 416,134	$ 88,873	$ 505,077
General and administrative			(441,289)
Interest			(575,096)
Loss before extraordinary item			$ (511,308)
Identifiable assets			
Property, plant and equipment			
Proved properties	$7,415,465	$ 16,445	$7,431,910
Unproved properties	1,196,798	—	1,196,798
Other	877,145	6,250	883,395
	$9,489,408	$ 22,695	$9,512,103

During the year ended June 30, 1987, overhead expenditures in the amount of $206,000 were capitalized.

	1986 Canada	1986 United States	1986 Total
Petroleum and natural gas sales	$2,223,117	$ 563,201	$ 2,786,318
Operating profit (loss)	$1,241,026	$(2,181,976	$ (940,950)
General and administrative			(579,014)
Interest			(660,789)
Loss before extraordinary item			$ (2,180,753)
Identifiable assets			
Property, plant and equipment			
Proved properties	$6,895,008	$ 965,310	$ 7,860,318
Unproved properties	1,391,000	—	1,391,000
Other	874,187	71,081	945,268
	$9,160,195	$ 1,036,391	$10,196,586

During the year ended June 30, 1986, overhead expenditures in the amount of $252,000 were capitalized.

8. ***Subsequent Events***

On August 28, 1987, the Corporation sold 500,000 Units, each Unit consisting of one $12.00 Oil Price Indexed Cumulative Redeemable Convertible Second Preference Share, Series A (the "Preference Shares") and one Gold Purchase Warrant for aggregate proceeds of $5,350,000, net of Agent's fees of $450,000 and after deducting share issue expenses estimated at $200,000. In connection with the sale, the Corporation granted an option to the Agent to purchase 1,320,000 Common Shares exercisable at any time until June 30, 1988 at an exercise price of $0.45 per Common Share. Proceeds from the sale in the amount of $250,000 will be used to reduce the bank loan, $1,000,000 will be placed on deposit with the Corporation's bank until February, 1988 as security for the bank loan and the balance will be used to finance the exploration for and development of petroleum and natural gas reserves.

Concurrent with the sale of the Units, the Corporation sold to its parent 100,000 Preference Shares at a price of $10.00 per Preference Share and purchased a call on up to 10,000 ounces of gold for $1,000,000.

NOTES

Corporate Information

Directors

Sylvester P. Boland
Dublin, Ireland
Executive Vice-President
Northgate Exploration Limited

James H. Coleman* +
Calgary, Alberta
Barrister & Solicitor
Partner, Macleod Dixon

Alex S. Cathcart*
Calgary, Alberta
Chairman
Barshaw Enterprises Ltd.

Patrick D. Downey
Toronto, Ontario
Vice-President & Controller
Northgate Exploration Limited

David H. Erickson +
Calgary, Alberta
Vice-President Exploration
Canadian Pioneer Oils Ltd.

Patrick J. Hughes
Dublin, Ireland
Chairman of the Board
Northgate Exploration Limited

John F. Kearney* +
Toronto, Ontario
President
Northgate Exploration Limited

Thomas C. Riddell
Calgary, Alberta
Vice-President Land & Secretary
Canadian Pioneer Oils Ltd.

* Member of Audit Committee
\+ Member of Executive Committee

Officers and Corporate Management

Patrick J. Hughes
Mining Executive
Chairman of the Board

John F. Kearney
Lawyer
President & Chief Executive

Patrick D. Downey
Chartered Accountant
Vice-President & Treasurer

David H. Erickson
Professional Geologist
Vice-President Exploration

Thomas C. Riddell
Petroleum Landman
Vice-President Land & Secretary

Auditors

Thorne Ernst & Whinney
1200, 205 - 5th Avenue S.W.
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Legal Counsel

Macleod Dixon
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Bankers

The Bank of British Columbia

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Registrar and Transfer Agent

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Stock Exchange Listing

The Alberta Stock Exchange
Common Share Symbol "CPO"
Preference Share Symbol "CPOP"
Gold Purchase Warrants "CPOW"

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